

Senate Bill 331 (Wright) Chapter 455*Report to Legislature – graphic artists*

Effective January 1, 2000. Adds an uncoded section.

This bill requires the Board, on or before January 15, 2000, to report to the Legislature on the sales or use tax revenue collected from any graphic artist, cartoonist, illustrator, commercial photographer, and advertising agency. The bill requires the report to additionally include the amount of sales or use tax assessed by the Board in any audits covering the reporting period for the 1997 calendar year that are attributable to unreported transactions of these taxpayers. The bill requires that the report itemize according to each of these categories of taxpayers.

Sponsor: Graphic Artists Guild

Law Prior to Amendment:

Under existing law, the sale of tangible personal property for consideration is subject to tax unless that property is specifically exempted or excluded from the computation of tax. The sales tax is based on the total gross receipts of retailers for the sale of tangible personal property, without any deduction on account of the cost of materials used, or any labor or services that are a part of the sale of the property. "Sale" is defined in Section 6006 to include, among other things, any transfer of title or possession for consideration. Therefore, when tangible personal property is transferred, such as a photograph, even temporarily, to a person and a charge is made granting the person the right to reproduce the tangible personal property (such as in a newspaper), the entire charge is subject to tax. However, in order for tax to apply, there must be a tangible item of property transferred. Therefore, if a photograph, for example, is transferred modem to modem, no tax would apply to that transfer.

Under existing law, when a sale of tangible personal property includes a charge for an intangible right to reproduce that property, the entire charge is generally subject to tax. This interpretation has been supported by case law. Specifically, in the matter of *Simplicity Pattern Company v. State Board of Equalization* (1980) 27Cal.3d 900, the Supreme Court held that the transfer of certain master film negatives to be used for reproduction purposes was a sale of tangible personal property and that the tax on the transfer was measurable by what the taxpayer received for the property as a whole, without any deduction for amounts paid for the intellectual or other intangible components.

There are some exceptions to the general law that imposes tax on the entire transaction amount without a deduction for the intangible element of the transfer. For example, under Sections 6011(c)(10) and 6012 (c)(10), “sales price” and “gross receipts” do not include the amount charged for intangible personal property transferred with tangible personal property under a “technology transfer agreement” in which a person who holds a patent or copyright interest assigns or licenses to another person the right to make and sell a product or to use a process that is subject to the patent or copyright interest. Another example includes the exemption under Section 6362.5 attributable to the amounts paid for the copyrightable, artistic or intangible elements in connection with the sale and purchase of master tapes and records. With regard to this exemption, only the actual tangible personal property incorporated into the tape or record is subject to tax.

Background:

During the 1997-98 Legislative Session, SB 664 (Wright) was before the Legislature to provide a sales and use tax exemption for charges for reproduction rights – similar to this measure prior to the June 1 amendments. As that measure was originally drafted, the Board estimated state and local revenue losses in the range \$110 million annually. Proponents asserted that the revenue loss was about half that identified by the Board.

To attempt to resolve these differences, the Legislative Analyst's Office (LAO) was asked to evaluate both estimates, but the LAO's findings did not lead to an agreement. It was concluded that making a more precise estimate of the revenue loss would be difficult, because specific data that were needed to definitively answer the question were not directly available. However, pursuant to a request by the LAO, Board staff reviewed sales tax accounts of 118 advertising agencies and graphic artists, and, based on the auditors’ knowledge of the specific business activities of those accounts, estimated that those companies alone reported \$14 million in state and local sales and use tax on transactions that included the granting of a right to reproduce an original work of art.

Board staff met with proponents and, based on additional information they provided, revised some of its assumptions and revised its estimated state and local revenue loss to \$57 million annually. The sponsors of the bill also revised their estimate and concluded that the bill would result in a state and local revenue loss of approximately \$9 million annually.

This significant discrepancy has been repeatedly discussed, debated, and reviewed by Board staff, the bill's sponsors, and the Legislative staff assigned to analyze the bill. However, specific data needed to definitively resolve the question are not directly available.

Comments:

1. **Purpose.** To resolve the revenue disagreement by requiring the Board to conduct a study of the total sales and use tax collected and assessed by the Board from the taxpayers.
2. **The report required by the bill will not require additional resources.** The data required for the report is accumulated by the Board and the costs to conduct such a study will be minimal.